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September 24, 2013

VIA ECFS

Marlene Dortch, Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: American Cable Association ("ACA") *Ex Parte* Filing on the Connect America Cost Model, WC Docket No. 10-90

Dear Ms. Dortch:

As part of its efforts to ensure that Connect America Fund ("CAF") Phase II support is distributed efficiently, in a June 12, 2012 *ex parte*, ACA submitted that based on current price benchmarks, expected broadband take rates, and a careful analysis of the principles underlying the Connect America Cost Model ("CACM"), the support threshold for CAF Phase II should be $64.[1] In its *ex parte* letter of September 3, 2013 concerning the CACM,[2] USTelecom challenges a number of points made by ACA in this *ex parte* and argues that the support benchmark should be in the range of $41 to $55.

ACA responds herein to USTelecom's filing:

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1 *See Ex Parte* Letter of American Cable Association, WC Docket No. 10-90, at 10 (June 12, 2013) ("*ACA Ex Parte*") ("ACA's recommended support threshold is $64, based on a 90% take rate and $71 ARPU benchmark.").

2 *See* USTelecom *Ex Parte* Rebuttal of the American Cable Association *Ex Parte* Filing in the Virtual Workshop in Response to Public Notice (DA 13-1136) on the Connect America Cost Model, WC Docket No. 10-90 (Sept. 3, 2013) ("*USTelecom Ex Parte*").

USTelecom's proposed support threshold erroneously dismisses ACA's recommendation of $64.

In opposing ACA's recommended average revenue per user ("ARPU") of $71 and support threshold of $64, USTelecom claims that "ACA did not provide any details necessary to replicate ACA's recommendation and did not provide sufficient specificity to permit others to develop needed details."[3] ACA disagrees.

In its June 12 *Ex Parte*, ACA provided a table showing (1) the ARPU for a double-play (including 4/1 Mbps broadband) offering for all 13 price cap local exchange carriers ("LECs") and (2) the number of locations unserved by a competitive provider within each carrier's service area.[4] ACA then developed a weighted support threshold recommendation based on each LEC's share of unserved locations.

ACA's ARPUs were based on research of "the lowest non-promotional, non-contract price advertised for broadband that had at least 4 Mbps downstream and 1 Mbps upstream and voice packages with unlimited local and long-distance minutes, if available. In the cases where pre-packaged bundled offers meeting those requirements were cheaper than a la carte pairings, ACA used those prices as benchmarks."[5] ACA acknowledges that it did not provide references to actual websites or marketing paraphernalia, but it found that pricing information is not readily discoverable. For most price cap LECs, one can only determine the standard price of services by entering geographical locations within a carrier's service area footprint into the price-finders on their websites. Only through repeated searches of multiple locations does it become apparent that price cap LEC's pricing for the same service does not appear to vary by location. Others who wish to perform the same laborious spot-checking will easily (if somewhat exhaustingly) be able to replicate ACA's results. In any event, ACA's derived ARPU of $71 is within USTelecom's range of $58.54 (promotional rate) and $76.03 (standard rate).[6]

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3 *USTelecom Ex Parte* at 4.

4 *See ACA Ex Parte* at 9. The number of unserved locations was a direct output of the CACM, and these figures are replicable.

5 *Id*.

6 *See USTelecom Ex Parte* at 5. The reason for the differing support threshold recommendations is the different assumed take rates. ACA assumes 90%. USTelecom assumes 80% for broadband and 60% for voice. In its *ex parte*, US Telecom provides no support for these assumptions.

USTelecom is incorrect that the five-year funding term undercompensates price cap local exchange carriers.

USTelecom consistently claims in its *ex parte* that the five-year term of CAF Phase II undercompensates price cap LECs because capital expenses like fiber and telephone poles are depreciated over much longer periods. This claim only holds if one expects price cap LECs to use CAF Phase II funding to build entirely new networks from scratch during this period—an expectation that not even USTelecom has.[7]

Instead, price cap LECs receiving CAF Phase II funding are expected to leverage their existing networks to serve CAF-mandated locations and replace capital equipment incrementally, as it wears down, breaks or becomes obsolete. The Gompertz-Makeham survival curve used by the CACM assumes staggered replacement of equipment throughout its expected lifespan due to, for instance, normal wear and tear, equipment failure, and accidents. Therefore, the CACM is aligned with the expected annual investment patterns of price cap LECs receiving CAF Phase II funding. The recipients would be expected not to replace their networks wholesale, but to replace equipment over time. Whether the funding term is for five years or 20 years is irrelevant; the incremental annual investment that results from the CACM's levelized cost mechanism was developed to approximate actual annual investment expected from price cap LECs.

USTelecom agrees with ACA that the Commission should use the same take rate for estimating costs and expected revenues.

USTelecom does not refute key points made by ACA in its *ex parte*. In response to ACA's statement "The FCC should not use one take rate for estimating costs and a different take rate for estimating expected revenues,"[8] USTelecom states that "the Coalition agrees that the FCC should not use one take rate for estimating costs and a different take rate for estimating expected revenues."[9] It then adds, however, that "ACA's concern that CAM will over-compensate an ILEC accepting CAF II funding based on CAM is misplaced,"[10] pointing to the

7 In its proposal for a CAF Phase II reverse auction mechanism for funds that price cap LECs decline to accept, USTelecom states, "…it is more efficient in the short-term to upgrade existing network facilities than to make greenfield deployments." *See* USTelecom *Ex Parte*, Connect America Fund Phase II: A Proposal for A State-And-County Based Approach To Reverse Auctions For CAF Phase II Support, WC Docket No. 10-90, at 18 (Aug. 29, 2013).

8 *ACA Ex Parte* at 3.

9 *USTelecom Ex Parte* at 2.

10 *Id.*

fact that the five-year funding term of CAF Phase II is not adequate to compensate the price cap LECs fully for capital expenses that are depreciated over much longer periods. As discussed above, ACA disagrees with the argument that the price cap LECs would be underfunded due to the five-year funding term. More importantly, the Wireline Competition Bureau has already concluded that, by using a levelized cost and terminal values of assets set to book value, the CACM will "estimate the cost of providing service in a the way that best approximates the discipline of a competitive market."[11] In any event, this argument is irrelevant to ACA's point about the take rate. It is not acceptable to use inconsistent modeling principles in one part of a model to offset supposed flaws (under-compensation) in another part.

In its June 12 *Ex Parte*, ACA said that the nature of the CACM causes price cap LECs to be "over-compensated slightly" because the model "compensates operators for variable costs years before they happen."[12] USTelecom challenges this statement (which is a minor point in ACA's overall argument) because the theory of a forward-looking cost model "does not recognize the timing of success-based locations as a business model does."[13] ACA does not dispute the theory, but it does dispute the reality, which is that the CACM compensates operators for variable costs such as drops and network interface devices years before an operator will build them.

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[11] *Connect America Fund*, WC Docket Nos. 10-90, 05-337, Report and Order, DA-13-807, ¶ 11 (Apr. 22, 2013).

[12] *ACA Ex Parte* at 4.

[13] *USTelecom Ex Parte* at 3.

Should you have any questions about ACA's analysis, please contact me.

Sincerely,

Thomas Cohen

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